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February 6, 2003

BY FEDERAL EXPRESS

Joel H. Peck, Clerk
State Corporation Commission
C/O Document Control Center
P.O. Box 2118
Richmond, VA 23218

Re: Case No. PUE-2002-00645

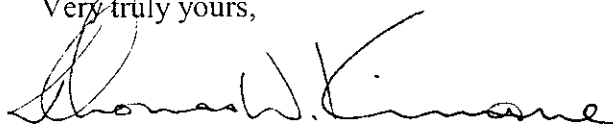
Dear Mr. Peck:

Please find enclosed, the original and 15 copies of the following documents for filing on behalf of Constellation NewEnergy, Inc. in the above-captioned matter:

- Notice of Interest and Intention to Participate
- Initial Comments Regarding Default Service

Kindly return the additional copies in the envelope I've provided. If you have any questions regarding this filing, please do not hesitate to contact me.

Very truly yours,



Thomas W. Kinnane
Attorney for Constellation NewEnergy, Inc.

TWK/tbm
Enclosures

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DOCUMENT CONTROL

BEFORE THE VIRGINIA STATE CORPORATION COMMISSION

Ex Parte: IN THE MATTER CONCERNING	*
THE PROVISION OF DEFAULT SERVICE	*
TO RETAIL CUSTOMERS UNDER THE	* CASE NO. PUE-2002-00645
PROVISIONS OF THE VIRGINIA	*
ELECTRIC UTILITY RESTRUCTURING	*
ACT	*

INITIAL COMMENTS OF CONSTELLATION NEWENERGY, INC. REGARDING DEFAULT SERVICE

COMES NOW Constellation NewEnergy, Inc. (hereinafter "CNE"), by and through its attorneys, Thomas W. Kinnane and the law office of Kinnane & Associates, Ltd., and files, pursuant to the Commission's Order Establishing Investigation of December 23, 2002, these Initial Comments Regarding Default Service.

1. What should be the specific components of default service?

CNE has done extensive work on default service (hereinafter "DS") design in various jurisdictions throughout the United States that have implemented retail choice programs. In fact, without question, the single most important factor in promoting customer choice is proper market-based pricing of default service. Important components of this service include: (1) wholesale service supply costs including energy, resource adequacy costs (capacity), congestion costs, shaping costs, volumetric and price risk adjustments, credit costs and other related wholesale costs; (2) transmission and ancillary costs; (3) retail costs; and (4) utility return. Additional retail services, including data usage processing, billing, collection, bad debt expense, customer care, credit costs, working capital, purchasing and payment costs and other general and administrative costs must be reflected in the retail price to customers. While it is recognized that many of these services are redundant with delivery service, there are alternative crediting

mechanisms that can be established that can help ensure that customers do not pay twice for these costs, and that further provide more appropriate price signals to consumers.

2. Should incumbent electric utilities continue to provide default service at capped rates at the present time; if so, what changes in statute, policy, infrastructure, market conditions, and/or other circumstances are necessary to allow for the practical provision of default service by an entity other than the incumbent?

It is widely recognized that many utilities have agreed to provide fixed retail generation rates for a defined period during the transition to a competitive market. In Virginia, a rate cap was mandated by statute through July 1, 2007 (in the absence of a competitive market). It is important to note, however, that this is a rate cap for bundled service. Thus, it may be conceivable that transmission and distribution costs could be decreased, and generation costs could be increased, thus maintaining the overall statutory requirement. The statute is unambiguous that the rates are to be capped until the market is deemed competitive.

The statute does not specify who shall provide this service. More explicitly, the statute clearly states that the Commission shall designate the DS provider and further allows that the Commission "may periodically, as necessary, conduct competitive bidding processes under procedures established by the Commission and, upon a finding that the public interest will be served, designate one or more willing and suitable providers to provide one or more components of such services, in one or more regions of the Commonwealth, to one or more classes of customers."¹ In the interest of promoting a competitive wholesale market, it seems desirable that the Commission would conduct a competitive bidding process to help promote liquidity, and introduce new sellers into the fledging market. Moreover, the goals of Section 56-596—the advancement of competition and economic development—would be achieved without a price impact on Virginia consumers.

¹ Virginia Ann. Code § 56-585(B)(2).

The development of competitive retail markets relies not only on equitable DS retail pricing mechanisms, but also on robust wholesale competition. Therefore CNE strongly supports the formation of Regional Transmission Organizations ("RTOs") and/or having the utilities join existing RTOs in order to promote wholesale competition.

3. What should the geographic scope of a default service provider's territory, i.e. statewide, incumbent utility service territory, regions served by specific regional transmission entities; divisions with an incumbent utility's service territory; major metropolitan and surrounding areas, etc.?

DS is generally provided on a utility-territory basis. Even in New Jersey, where an annual statewide auction is held, the individual bid blocks are further segmented by utility and by customer classifications. Any such design should balance the need to have reasonably homogenous customer groupings against the need to avoid an unduly complex bidding structure. Bid blocks should mimic energy trading blocks as closely as practicable in order to attract as many competitive bidders as possible.

4. Should default service be limited to those services contemplated by Section 56-585 of the Act?

CNE generally defines DS as the provision of supply service to retail customers. If the intent of this inquiry is to discuss the need for further unbundling of metering, billing and collection, or other services, CNE avers that these peripheral issues should be discussed in separate forums. DS can be a very complex issue that deserves focused attention to certain critical process issues. CNE does not recommend further complicating the process at this time with other competitive service issues.

5. Should separate components of generation service to retail customers (capacity of resource reservation, energy, transmission, and ancillary services) be treated as separate default services or bundled into a single service?

In response to question 1, CNE articulated the need to include all of these elements, and additional cost elements, in the retail default service price. It seems logical to display these various cost elements for default (supply) service as a bundled default service price. The utility should continue to separately state the costs for any delivery service and taxes, so that customers can clearly delineate what savings can be achieved if they choose another supplier for their energy requirements.

6. Should generation related default service be delivered to the retail customer or to the incumbent utility?

There are two different DS models. Some states have pursued a model whereby the DS provider provides all retail and wholesale services (billing, collection, customer service, etc.) and is "assigned" to individual customers. For purposes of simplicity, this is referred to as a "retail DS model". Other states funnel the full requirements supply service through the utility that provides many of the retail services necessary to deliver the supply product to individual customers. This is often referred to as a "wholesale DS model".

The retail DS model is theoretically a more pure cost model since the default service provider is providing all supply related services. This eliminates the need to develop retail pricing methodologies or alternative crediting mechanisms that are required when the utility provides the service. However, this model raises a number of consumer protection and regulatory issues that arise when an entity other than the utility provides a regulated service. Alternatively, the wholesale DS model raises no jurisdictional issues and requires no modification of the consumer protection rules, since the utility continues to deliver this retail

service to the customers. However, it is critical that the utility's price for DS reflects certain retail costs or that an alternative crediting mechanism be developed so as not to handicap competitive supply services in the Commonwealth. The wholesale DS model does appear to be a more common structure for DS. It is presumed that this largely reflects the fact that residential and small commercial customers are more comfortable with a service provided through a regulated incumbent utility. At an early stage in transition to competitive markets, and for service to residential and small commercial customers, CNE recommends the wholesale DS model as long as the utility's retail price is set appropriately or alternative crediting mechanisms are developed.

7. Does the language of the statute prohibit the provision of default service to an incumbent utility on behalf of a group of customers (i.e. could a third party provide service to any incumbent utility for indirect service to retail customers – service to satisfy load growth, specific localities, or to customer subgroups)?

The statute does not appear to preclude any such arrangement. The statutory language specifically permits the provision of default service to vary along the lines of "classes of customers".² This appears to provide the flexibility to have separate provisions for default service for various customer groupings.

8. Should the provision of default service differ by customer class?

In most jurisdictions, the provision of DS does vary by customer class. In general, there is recognition that larger customers have greater choice of competitive suppliers, and have more experience in dealing with CSPs. For these customers, shorter-term utility supply options are generally more appropriate. These customers tend to participate much more actively in the competitive arena, and it would be inappropriate for DS providers to enter into longer-term contracts for load that is less likely to remain with the DS provider. In contrast, residential and

² Virginia Ann. Code § 56-585(D, E).

small commercial customers tend to migrate to CSPs much more slowly, and tend to favor more stable pricing. DS products that are supported by a blend of one to three year full-requirements contracts are generally more appropriate.

It is also important that any such competitive bidding blocks would be broken down into a reasonable number of subgroups, so that the customer segments are reasonably homogenous in profile.

9. Can different components of default service be provided by different suppliers?

To the extent the wholesale DS model is the preferred method of providing default service, the incumbent utility will be providing the retail service components to DS customers. In some jurisdictions, as proposed in Maryland, the utility also provides the integrated transmission service. The wholesale supplier provides all other wholesale supply related services. Under the retail DS model, a DS provider would provide all components of default service directly to DS customers; utilities would provide only distribution service.

In a competitive bidding scenario, different suppliers could also provide different types of DS, based on the nature of DS for each customer class. It is also technically feasible that multiple blocks of supply for one particular utility and customer class combination could be provided by multiple suppliers who each won a certain percentage share of the bid for that class.

10. Should default service have the same meaning for different classes of customers (i.e., those who do not affirmatively select a supplier, those who are unable to obtain service from an alternative supplier, or those that have contracted with an alternative supplier who fails to perform)?

CNE does not recommend that there be a differentiation among these various needs for default service. This would probably add an additional element of complexity to the default service bidding that is not warranted. Furthermore, CNE believes that all customers should be able to choose DS, regardless of whether or not those customers had previously chosen to

participate in the competitive retail market. The DS model, however, should include a mechanism that will allow the wholesale supplier to mitigate the risks associated with customer migration to and from DS through such mechanisms as seasonal pricing, risk premiums and incremental pricing structures. DS structures that penalize customers for participating in retail choice do not advance the objective of competitive markets and should not be implemented.

11. How should charges for default service be collected?

Collection from retail customers under a wholesale DS model would continue in much the same fashion as is done today. The utility would collect from its customers through its normal billing processes and would have the responsibility for payment to the wholesale supplier. Charges for DS based on a retail DS model would be collected directly from retail customers by the DS provider consistent with the CSP Rules established by the Commission. As discussed previously, it may be appropriate to establish a forum to discuss what changes, if any, need to be made to consumer protection standards in light of this change in default supplier for this model.

12. Should metering, billing and collecting services be deemed components of default service?

Please refer to response in question 4.

13. What implications would the alternative provisions of default service have for the determination of wires charges?

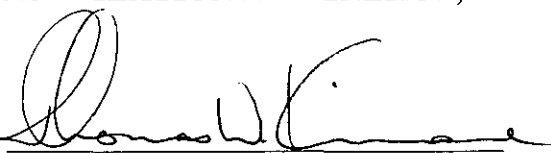
The statute appears to be silent on whether wires charges are a component of DS. CNE supports the collection of verifiable and prudently incurred stranded costs of utilities and cooperatives that were incurred prior to the passage of the Restructuring Act. To the extent that the provision of DS threaten the collection of any such costs, the Commission will need to address this issue.

CONCLUSION

CNE appreciates the opportunity it has been afforded by the Commission to comment on and participate in the development of default service pursuant to the Virginia Electric Utility Restructuring Act. CNE looks forward to participation in the Default Service Working Group, Staff's subsequent report and further comment by the parties.

Respectfully submitted,

CONSTELLATION NEWENERGY, INC.

By: 

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